VZCZCXRO6703
RR RUEHAG RUEHAST RUEHDA RUEHDBU RUEHDF RUEHFL RUEHIK RUEHKW RUEHLA
RUEHLN RUEHLZ RUEHNP RUEHPOD RUEHROV RUEHSK RUEHSL RUEHSR RUEHVK
RUEHYG
DE RUEHAK #0958/01 1871306
ZNR UUUUU ZZH
R 061306Z JUL 09
FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC 0117
INFO RUEATRS/TREASURY DEPT WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC
RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEHIT/AMCONSUL ISTANBUL 5954
RUEHDA/AMCONSUL ADANA 3973

UNCLAS SECTION 01 OF 02 ANKARA 000958

TREASURY FOR INTERNATIONAL AFFAIRS - JWEISS

SENSITIVE
SIPDIS

REF: ANKARA 2052

E.O. 12958: N/A
TAGS: EFIN ECON TU

SUBJ: TURKISH ECONOMY CONTRACTS 13.8 PERCENT IN FIRST QUARTER

ANKARA 00000958 001.2 OF 002

This cable is sensitive by unclassified. Please protect accordingly.

¶1. Summary: The Turkish economy contracted at a higher-than-expected 13.8% year-on-year rate in the first quarter of 2009, its worst quarter since World War II, one of the worst performances among emerging European economies, and the worst performance by an OECD member. The sharp drop was driven by a collapse of domestic consumption and spending, and the Turkish Treasury plans to respond by increasing its domestic borrowing for public expenditures to offset the declining private spending (the GOT's debt rollover ratio will exceed 100% this year). Analysts are divided on whether the Turkish economy has bottomed out or if the worst is still to come. Several economists revised their annual growth targets downward to negative 5.5% to 7.0% for 2009 following the recent data. The GOT still expects an annual contraction of 4 to 4.5%. End Summary

¶2. (U) Turkey's economy contracted at the highest rate since World War Two with a first quarter 2009 decline of 13.8% in real terms. Value added in all sectors, except for financial institutions and hotels, declined drastically as well. The 6.2% drop in GDP in the last quarter of 2008 had presaged further declines in 2009, but the extent of the contraction surprised many analysts. Economists had been expecting a sharp contraction of around 12% in first quarter growth data. Following the release of the data, the Industry Ministry reiterated its claim that GDP will fall only 4.0 - 4.5% in 2009.

¶3. (U) In the breakdown of the data, the highest rate of decline was in the wholesale and retail trade sectors which fell 25.4%, followed by construction (-18.9%) and manufacturing (-18.5%). Positive growth was recorded only in the financial sector and the hotel business. The financial sector grew 10.7%, largely a result of banks investing heavily in government securities. The hotel sector grew at 2.9%, likely due to the more favourable lira exchange rate for tourists and a series of rate-slashing campaigns. Private consumption dropped by 9.2% year-on-year, even worse than the 2001 crisis. Similarly, private investments slipped by 35.8%. Public

consumption continued to contribute positively to overall GDP with growth of 5.7%, mostly increased GOT spending leading up to the March 29 local elections. Public sector investments grew 25%, in contrast to the sharp fall in private sector investments. Even the agriculture sector fell 3%, despite the favourable weather conditions.

¶4. (SBU) While the first quarter 2009 growth data is discouraging, local economists are unsure whether the economy has bottomed out. Most economists and Turkish officials agree that the first quarter saw the worst of the crisis and a gradual recovery will begin in the second quarter, with positive growth in the last quarter of 2009. Central Bank Governor Durmus Yilmaz said the economic recovery will be slow, but the Central Bank (CBT) expects growth to resume again by 2010. Ufuk Hazirolan, Deputy Director General for Public Finance at Turkish Treasury, told us that the growth rate was "worrisome" in the first quarter. Hazirolan said the Turkish Treasury will need respond to the data by increasing its domestic borrowing for public expenditures to offset declining private spending, also noting that despite the increasing debt stock, borrowing cost was decreasing due to the favourable market conditions (Note: Turkish Treasury's rollover ratio increased to above 100% in 2009 vice a 75-80% ratio prior to the crisis, mostly due to increased GOT spending. End note). Despite his concerns, Hazirolan said he believed the economy has seen the worst.

¶5. (SBU) CBT Markets Deputy Director General Ali Cuhadar said that slowing demand has dampened inflationary pressures and the CBT now expects annual inflation to come in at 5.3% versus the target of 6.5%. Cuhadar noted that the increased rollover ratios in Treasury borrowing led to a crowding out of funds available for the private

sector, inhibiting that engine for growth, as banks started to invest in government securities instead of lending. Cuhadar also said if there is no IMF deal, then the recovery may take much longer. Economists like Servet Yildirim from CNBC-e, Baturalp Candemir from EFG Securities in Istanbul and Erhan Aslanoglu from Marmara University expect a slow recovery period, but add that the recovery will also depend on how fast Europe recovers.

¶6. (SBU) Comment: The GDP first quarter reading was, driven by remarkable declines in private consumption and expenditures. Indicators on the production and consumption sides point to a better picture in the second quarter, however, partly stimulated by the introduction in March of temporary tax cuts (value added tax and special consumption tax) in automotives, white goods, electronics, furniture and IT products. As these incentives are scheduled to go away in September, however, they may just lend a temporary blip to growth.

¶7. (SBU) Comment cont'd: Export markets will remain subdued, inhibiting a more permanent recovery, although this will be offset somewhat by the contraction in imports, which fell 43.9% in May 2009 from May 2008. If oil prices continue to rise, however, imports may increase before exports recover, raising additional risks for growth and adding to external financing pressures. Most economists we talk to expect economic activity to keep contracting in the second and third quarters, though at a lesser pace, followed by a mild recovery in the last quarter, and expect an annual 5.5 to 7% GDP contraction for 2009, with risks to the downside. End comment.

JEFFREY